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BALANCE OF PAYMENTS REPORT

22 November 2017

Despite the deteriorating C/A balance and financing capacity, the external debt trajectory remained sustainable

- In Q3 2017, on the back of subdued EU fund absorption as well as owing to fundamental factors, Romania's external balance indicators deteriorated (see Chart 1). The sharp setback caused by falling EU funds is expected to be reversed, but the more general, slowly declining trajectory of the indicators may continue, given the country's position in the business cycle. Apparently, Romania's economy is at the peak of the cycle, fuelled also by fiscal stimulus measures. In this context, the robust domestic demand started to put pressure on the current account. Nevertheless, we do not expect a sudden explosion of the deficit in the quarters ahead.
- Foreign direct investments, supported by the buoyant external environment, and the recovery of EU fund absorption may broadly cover the gradually rising C/A gap. Therefore, and also due to the low debt ratio and robust nominal GDP growth, we think that the external debt trajectory is still on a sustainable path. Just as importantly, the size of the NBR's foreign exchange reserve seems to be adequate. Pro-cyclical fiscal measures, indeed, resulted in significantly higher risks, but these are mitigated to some extent by the fact that households are still more cautious than before the crisis (Chart 2), and companies are rather reluctant to launch large-scale investments. Undoubtedly, developments regarding the government budget should remain in the focus of attention, and a potential change in households' and companies' behaviour is also worth monitoring. We also underscore that Romania records less cheering C/A and EFC balances than some of its peers in the CEE region (Chart 12).
- At the end of Q3 2017, the C/A gap was at 2.6% of GDP, a bit wider than a quarter earlier (2.5%, see Chart 4), as the balance of goods followed downwards trajectory and the surplus of the services account dropped slightly. On the other hand, the deficit of primary incomes decreased, as companies paid smaller amounts to their foreign shareholders, which had a positive impact on the C/A balance. At the same time, the EFC1 benchmark (external financing capacity, the sum of the current account and the capital balance) fell to -1.9% of GDP, down from -1.3% a quarter earlier, mostly as a result of a significant deceleration in EU fund absorption (Chart 3). The EFC2 indicator (EFC1 plus net errors and omissions; probably the first best measure for underlying trends) also recorded a drop in Q3, pointing to 1.6% deficit. Besides the drop in EU transfers, lower net errors and omissions (NEO) also played an important role in the widening gap (NEO reflect the imbalances resulting from imperfections in source data and compilation of the balance of payments accounts).
- The details of the Q3 statistics show that the trade balance gap widened (Chart 4), chiefly driven by higher demand for consumer goods (Chart 5). Other product types had only a modest impact on the C/A balance. A significant portion of intermediate goods is imported to produce other products for exports, while the demand for capital goods remained weak owing to subdued investment activity (Chart 6). In the case of services, the surplus remained very large, at 4.3% of GDP, but less than the 4.5% a quarter earlier (Chart 7). The import of services got impetus chiefly on the back of the demand-sensitive travel segment. Simultaneously, exports pointed to a slower growth pace as IT&C, transport and other business services lost some momentum. It appears that the shortage of qualified workforce started to weigh on the export of services.
- Net inward FDI flows were robust, reaching 2.5% of GDP in Q3, up from 2.3% in Q2 (Chart 8). Their structure was also healthy, with the equity portion driving the positive inflow.
- The robust FDI flow and still modest external financing gap helped Romania's external debt to decrease. The debt ratio (excluding intercompany lending) dropped by 1.5 percentage-points, to 37% in Q3 2017 (Chart 9&10). Commercial banks continued to scale back their liabilities, but the external debt of the government also eased, after a loan repayment to the European Commission in September. The drop in the case of the government debt is probably rather temporary, as the Ministry of Finance tapped external markets in October, issuing bonds in value of EUR 1 billion.
- Chiefly due to the revisions to the historical balance of payment data, as well as stronger-than-expected GDP growth, we expect Romania's current account deficit to end this year at 3% of GDP, 0.4 percentage points lower than we previously thought. Nevertheless, we left our 2018 C/A gap projection unchanged at 3.7%.

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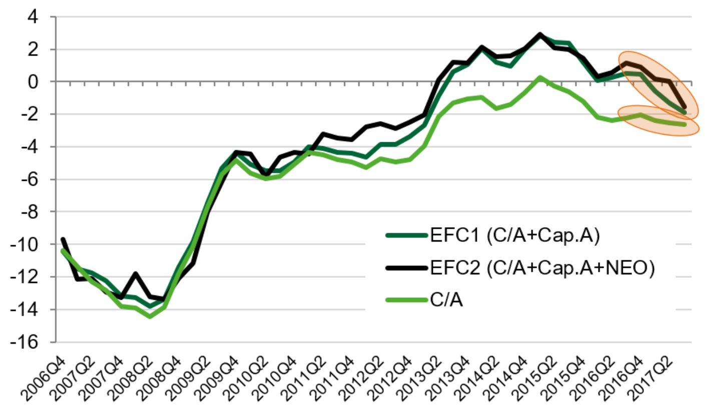
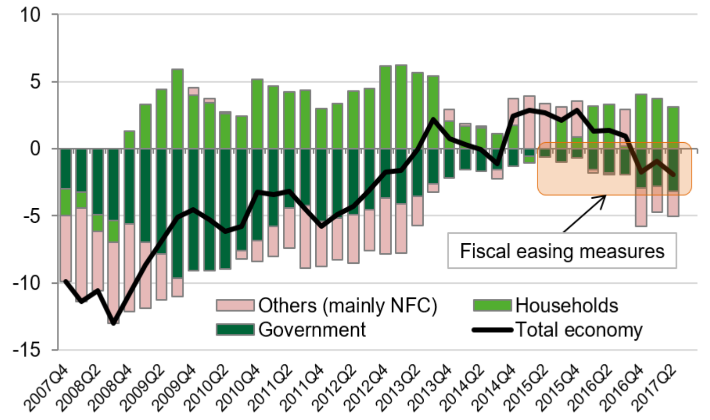
Chart set:

Chart 1: Main indicators of external balance (as % of GDP, 4Q rolling)



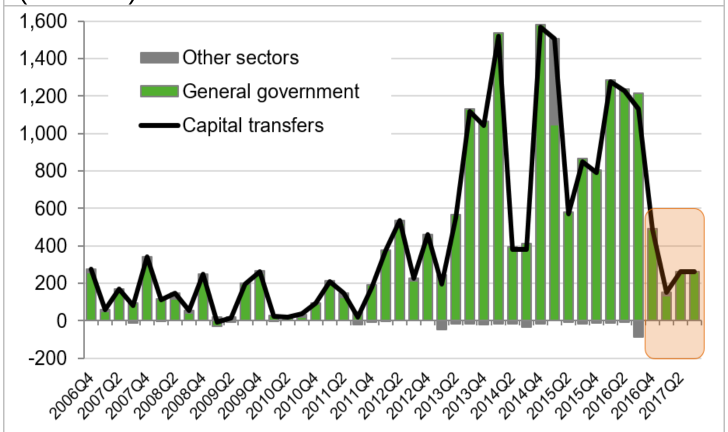
Sources: NBR, NIS, OTP Research
*Note: **EFC1** (External financing capacity 1) = Current account + Capital account; **EFC2** (External financing capacity 2) = EFC1 + Net errors and omissions*

Chart 2: Net financing capacity of the main sectors and the whole economy (as % of GDP, 4Q rolling)



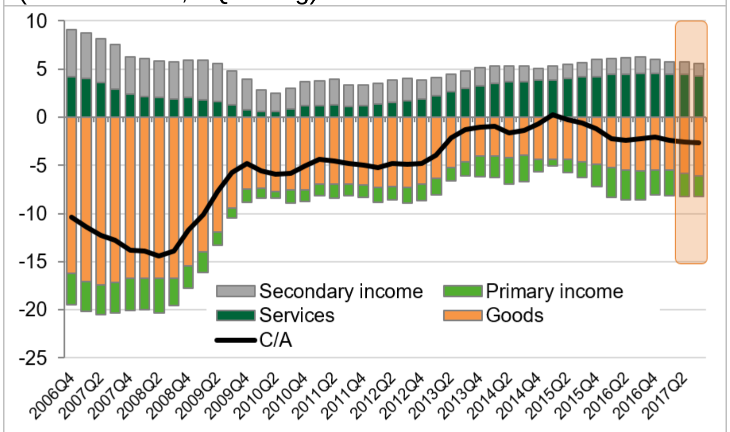
Sources: NBR, NIS, OTP Research
Note: Q3 2017 data is not available yet

Chart 3: Capital transfers (EUR mn)



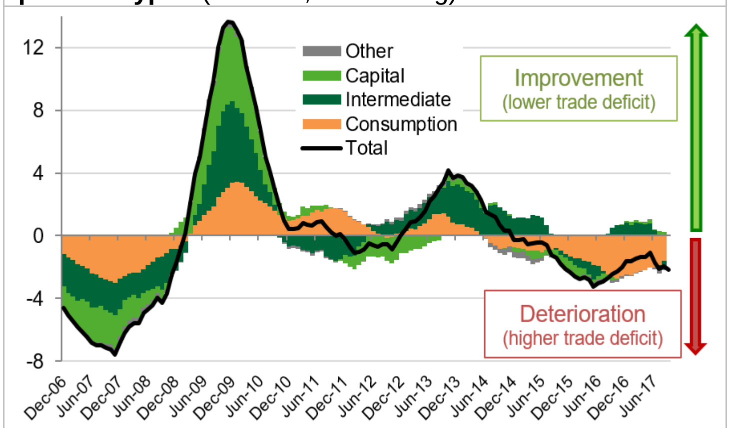
Sources: NBR, OTP Research

Chart 4: Current account by its main components (as % of GDP, 4Q rolling)



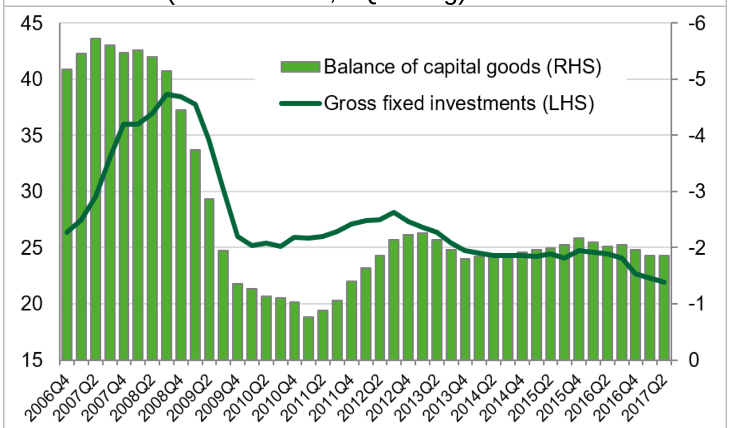
Sources: NBR, NIS, OTP Research

Chart 5: Change in the balance of goods by main product types (EUR bn, 12M rolling)



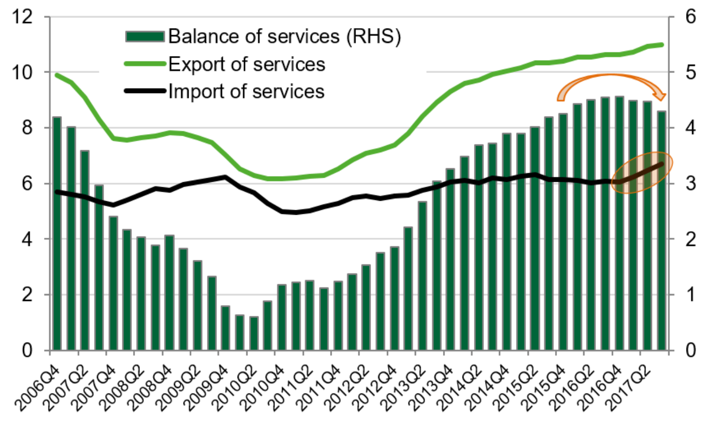
Sources: Eurostat, OTP Research

Chart 6: Balance of capital goods vs. gross fixed investment (as % of GDP, 4Q rolling)



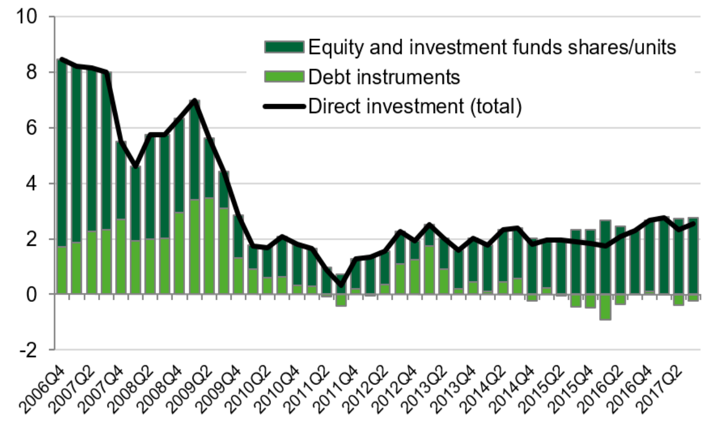
Sources: NBR, NIS, OTP Research

Chart 7: Services' account
(as % of GDP, 4Q rolling)



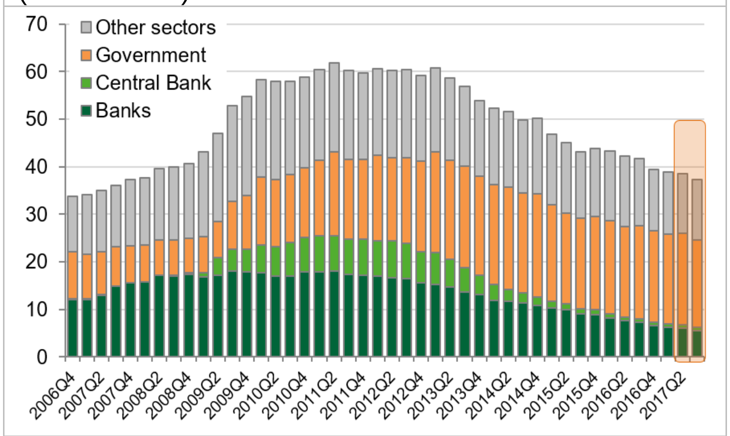
Sources: NBR, NIS, OTP Research

Chart 8: Net direct investment
(as % of GDP, 4Q rolling)



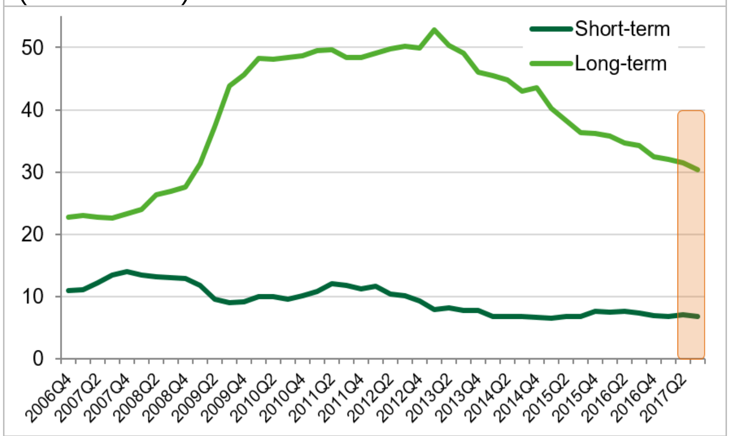
Sources: Sources: NBR, NIS, OTP Research

Chart 9: Gross external debt by sectors
(as % of GDP)



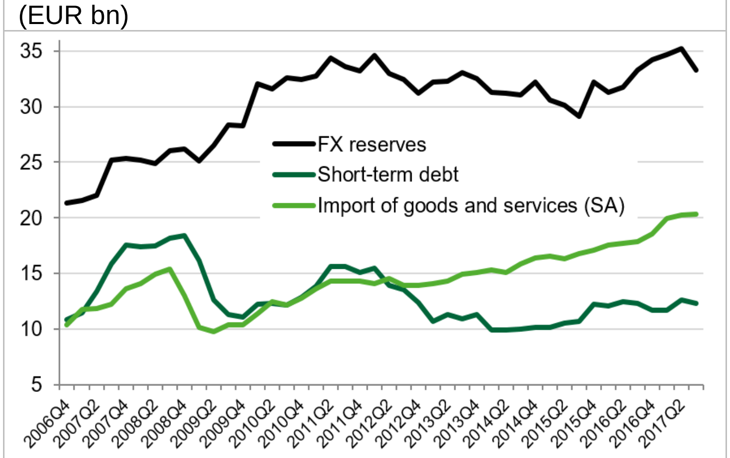
Sources: NBR, NIS, OTP Research
Note: without intercompany lending; based on BPM5 methodology until 2012 Q4

Chart 10: Gross external debt by tenor
(as % of GDP)



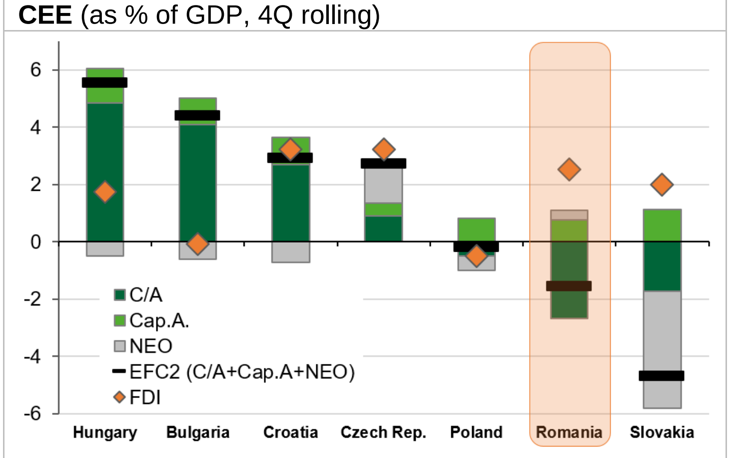
Sources: NBR, NIS, OTP Research
Note: without intercompany lending; based on BPM5 methodology until 2012 Q4

Chart 11: Reserves and reserve adequacy rules
(EUR bn)



Sources: NBR, NIS, OTP Research
Note: without intercompany lending; based on BPM5 methodology until 2012 Q4

Chart 12: Main indicators of external balance in the CEE (as % of GDP, 4Q rolling)



Sources: NBR, NIS, OTP Research
Note: ***EFC2*** *(External financing capacity 2) = Current account + Capital account + Net errors and omissions; Romania as of Q3 2017, other CEE as of Q2 2017*

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